

Message Text

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ACTION NEA-10

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FM AMCONSUL JERUSALEM

TO SECSTATE WASHDC IMMEDIATE 6210

INFO AMEMBASSY CAIRO

AMEMBASSY TEL AVIV

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DEPT PASS TREASURY FOR ASST. SECRETARY HICKMAN
CAIRO FOR PATRICK

E.O. 11652: N/A

TAGS: OVIP (PARSKY G.)

SUBJ: U.S.-ISRAELI TAX TREATY

1. NEGOTIATIONS COMPLETED WITH AGREEMENT ON ALL
POINTS EXCEPT FORM OF ISRAELI GRANTS WHICH U.S. WILL
TREAT AS CAPITAL CONTRIBUTIONS TO DISTINGUISH THEM
FROM REDUCTION OF TAX. IN ADDITION, CAPITAL GAINS
ARTICLE IN PRESENTLY OMITTED WITH U.S. ASKED TO CONSIDER
TREATING SALES OF SUBSTANTIAL STOCK INTERESTS IN ISRAELI
CORPORATIONS AS ISRAELI SOURCE INCOME.

2. DRAFT WILL BE DELIVERED TO TREASURY (FOSTER)
EARLY NEXT WEEK BY JACQUES GORLIN OR EARLIER ARRIVAL TO
BE RETYPED ON AUTOMATIC TYPEWRITER. BASSETT SHOULD
MAKE MINOR DRAFTING CHANGES AS REQUIRED. THEIR EMBASSY
WILL CONTACT FOSTER TO PICK UP RETYPED COPY FOR
TRANSMISSION TO ISRAEL PRIOR TO DEPARTURE OF ISRAELI
DELEGATION FOR WASHINGTON. MARK DRAFTING CHANGES OR
CORRECTIONS ON ONE COPY.

3. JOINT INVESTMENT COMMISSIMY CONTEMPLATES THAT
A TREATY MAY BE INITIALED WITH FANFARE IN WASHINGTON ON
NOVEMBER 18 OR 19 BY FINANCE MINISTERS IF AGREEMENT
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IS REACHED ON ALL QUESTIONS. THEIR TAX REPRESENTATIVES

PLAN TO ARRIVE A FEW DAYS IN ADVANCE TO REVIEW DRAFT
AND DISCUSS GRANT AND CAPITAL GAINS ISSUE.

4. WE MUST DECIDE WHETHER THEIR PLAN FOR GRANTS
IS SUFFICIENTLY DIFFERENT FROM TAX SPARING. THEY HAVE
PRESENT GRANTS WHICH ARE GIVEN WITH RESPECT TO
APPROVED PROJECTS WITHOUT REGARD TO PROFITS OR TAXES.
THESE WOULD NOT CREATE A PROBLEM. THEY CONTEMPLATE AN
ADDITIONAL PROCEDURE THAT RAISES THE ISSUE.

PROPOSAL WOULD BE THAT AN INTERAGENCY INVESTMENT
COMMITTEE WOULD APPROVE LOANS TO APPROVED ENTERPRISES
AND UPON LATER REVIEW WOULD CANCEL THE LOANS IF THEY
ENTERPRISE MET THE INVESTMENT OBJECTIVE, I.E., WERE
SUCCESSFUL.

WE HAVE ARGUED THAT GIVING GRANT (I.E., FORGIVING
OF LOAN) SHOULD BE TRIGGERED BY VENTURE MEETING
OBJECTIVES FOR WHICH LOAN WAS GRANTED. THUS, IF
OBJECTIVE WAS TO INCREASE EXPORTS AND IF EXPORTS
INCREASE, LOAN WOULD BE WHOLLY OR PARTIALLY FORGIVEN.
SO TOO WITH EMPLOYMENT OBJECTIVES, ETC. ISRAELIS
AGREED, BUT SAID THAT OBJECTIVE FREQUENTLY IS TO BE
QUOTE BE SUCCESSFUL UNQUOTE, I.E., TO EARN PROFITS.
WE REPLIED THAT DELEGATION THOUGHT FORGIVENESS TIED TO
PROFITABILITY IN SUCH CASES PROBABLY OKAY IF AMOUNT OF
FORGIVENESS NOT TIED TO AMOUNT OF PROFITS OR AMOUNT OF
TAX WHICH WOULD HAVE BEEN SPARED HAD TAX SPARING CREDIT
BEEN GIVEN, ALTHOUGH EVEN THIS WAS SUBJECT TO FURTHER
CONSIDERATION IN WASHINGTON. THEY RESPONDED, CANDIDLY,
THAT THIS IS IN FACT WHAT THEY WOULD LIKE TO DO AND
SOUGHT WAY TO EXPRESS LIMITATION ON LINK OF GRANT TO
TAX OR TAXABLE INCOME WHICH WOULD NOT IN FACT LIMIT
THEIR ACTIONS. WE NOTED U.S. CONCERN WITH SUBSTANCE
AND NOT FORM AND THAT STRUCTURE OF ISRAELI GRANT WOULD
HAVE TO BE SUBSTANTIVELY DIFFERENT FROM TAX SPARING.
IF THEY PERSIST IN SEEKING A GIMMICK WE DO NOT SEE
POSSIBILITY OF SUCH A PROVISION IN TREATY. ON THE
OTHER HAND, THEY ARE IN THE PROCESS OF FORMULATING A
NEW INVESTMENT APPROACH AND IF THEY APPLY THE
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GRANTS OR FORGIVENESS OF LOANS TO BOTH PROFITABLE AND
NON-PROFITABLE ENTERPRISES, OUR APPROACH WOULD
PROVIDE CERTAINTY OF TAX TREATMENT AND BE A TREATY
BENEFIT. WE PROPOSED THE FOLLOWING DRAFT TEXT FOR
TREATY AS MERELY A DRAFT TO BE REVIEWED IN WASHINGTON.

BEGIN QUOTE. ARTICLE 9A. SPECIAL GRANTS:

1. FOR PURPOSES OF COMPUTING UNITED STATES TAX,

IF ISRAEL, A POLITICAL SUBDIVISION THEREOF, OR ANY AGENCY OF EITHER MAKES A CONTRIBUTION TO THE CAPITAL OF A CORPORATION IN THE CAPACITY NOT AS A SHAREHOLDER AS SUCH, A PROPER ELECTION IS MADE, AND SUCH CONTRIBUTION IS IN THE FORM OF --

A. PROPERTY OTHER THAN MONEY, THEY THE BASIS OF THE PROPERTY SHALL BE ZERO.

B. MONEY, THEN THE BASIS (TO THE EXTENT THEREOF) OF THE PROPERTY ACQUIRED WITH SUCH MONEY SHALL BE REDUCED BY THE AMOUNT OF SUCH MONEY AND ANY EXCESS AMOUNT OF MONEY SHALL BE APPLIED TO REDUCE THE BASIS OF OTHER PROPERTY.

C. A CANCELLATION OF INDEBTEDNESS, THEY THE BASIS OF APPROPRIATE PROPERTY SHALL BE REDUCED BY THE AMOUNT OF THE INDEBTEDNESS CANCELLED.

2. THE SECRETARY OF THE TREASURY OR HIS DELEGATE SHALL PRESCRIBE REGULATIONS SETTING FORTH (I) THE MANNER OF MAKING AN ELECTION UNDER PARAGRAPH (1), (II) THE MANNER OF DETERMINING PARTICULAR PROPERTIES TO WHICH ANY BASIS REDUCTION UNDER PARAGRAPH (1) (B) OR (C) SHALL BE ALLOCATED, AND (III) THE TIME AND MANNER FOR MAKING SUCH REDUCTIONS AND ALLOCATIONS.

3. FOR PURPOSES OF PARAGRAPH (1), A CONTRIBUTION TO CAPITAL MEANS A GRANT BY ISRAEL, A POLITICAL SUBDIVISION THEREOF, OR ANY AGENCY OF EITHER, INCLUDING THE CANCELLATION OF AN INDEBTEDNESS OWED TO ISRAEL, A POLITICAL SUBDIVISION THEREOF, OR ANY AGENCY OF EITHER IF AN ELECTION IS MADE PURSUANT TO REGULATIONS PRESCRIBED BY THE SECRETARY OF THE TREASURY OR HIS DELEGATE TO THAT EFFECT. SUCH TERM DOES NOT INCLUDE ANY AMOUNT WHICH IN WHOLE OR IN PART, DIRECTLY OR INDIRECTLY, (I) IS IN CONSIDERATION FOR SERVICES LIMITED OFFICIAL USE

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RENDERED OR TO BE RENDERED OR FOR SALE OF GOODS OR (II) IS MEASURED IN ANY MANNER BY THE AMOUNT OR PROFITS OR TAX LIABILITY. END QUOTE.

WE ATTEMPTED TO PIN DOWN THEIR POSITION BY THE FOLLOWING DISCUSSION DRAFT FOR POSSIBLE EXCHANGE OF NOTES.

BEGIN QUOTE: IT IS UNDERSTOOD THAT A GRANT QUALIFYING UNDER THE PROVISIONS OF ARTICLE 9A WILL BE GIVEN IF, AND TO THE EXTENT THAT, THE ENTERPRISE FULFILLS THE APPROVED PROJECT'S OBJECTIVES SUCCESSFULLY, WHICH MAY INCLUDE CREATING EMPLOYMENT, GENERATING OR CONSERVING FOREIGN EXCHANGE, AND SUPPLYING NECESSARY PRODUCTS OR SERVICES. THE FULFILLMENT OF THESE OBJECTIVES AND THE AMOUNT OF THE GRANT (WHETHER BY

CANCELLATION OF INDEPTEDNESS OR OTHERWISE) SHALL
NOT BE MEASURED PRIMARILY BY REFERENCE TO THE AMOUNT
OF PROFITS GENERATED BY THE ENTERPRISE OR ITS TAX
LIABILITY. END QUOTE.

THEY OBJECTED TO SECOND SENTENCE SUGGESTING AS A MINIMUM REPLACING
PRIMARILY BE EXCLUSIVELY. FURTHER PROBLEM IS RAISED BY
LIKLIHOOD THAT AN ENTERPRISE PROBLAY WILL NOT GET BOTH TAX
SPARING AND GRANTS. IN VIEW OF VAGUENESS OF THEIR PROPOSAL WE MUST
AWAIT THEIR FORMULATION OF CRITERIA FOR GRANTS AND FURTHER
FORMULATION OF CRITERIA FOR GRANTS AND FURTHER DISCUSSIONS
BETWEEN PARSKY AND FINANCE MINISTER. WE WILL TELEPHONE FROM
NEXT STOP TO ATTEMPT TO COORDINATE MOVEMENT ON THIS. IT IS
POSSIBLE THAT THEY WILL USE THE PROVISION WITH OUR LIMITATIONS
ON STRAIGHT FORWARD GRANTS ONLY.

5. CAPITAL GAINS ARGUMENT IS SIMPLY THAT A SUBSTANTIAL
INTEREST IN A CORPORATION IS LIKE OWNING THE UNDERLYING ASSETS
AND WHY SHOULD OUR PASSAGE OF TITLE THEORY GIVE THE U.S. THE TAX
REVENUES JUST BECAUSE U.S. RESIDENTS SELL THE STOCK OF AN
ISRAELI CORPORATION IN NEW YORK.

6. MARGARET DAY

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